

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 98-006

This document may not be used or cited as precedent. Code of Alabama 1975, §40-2A-5(a).

TO:

FROM: H. E. "Gene" Monroe, Jr.
Commissioner of Revenue

DATE: July 24, 1998

FACTS

The facts, as stated by Company A's representative, are:

Company A, a corporation with its principal place of business at _____, and the parent of a consolidated group of companies (collectively referred to as "A Group"), is 100% owned by the Company A Employee Stock Ownership Plan ("ESOP"). Company A is an S corporation. The members of A Group are Qualified Subchapter S Subsidiaries of Company A. The ESOP is a trust and recognized under IRC Sec. 409 and via Section 401(a) is exempt from federal income tax under IRC Sec. 501(a). Company A/A Group will file tax returns in Alabama and several other states.

ISSUE

How are the income distributions from Company A to the ESOP treated for Alabama income tax purposes?

GENERAL DISCUSSION

For the purpose of issuing this ruling, I make several presumptions. First, I presume that Company A qualifies as an "Alabama S corporation" pursuant to the

requirements of Code of Ala. 1975, §40-18-160(b)(1). Second, I presume that each member of the A Group (qualified subchapter S subsidiaries) is an "Alabama S corporation" as defined in Code of Ala. 1975, §40-18-160(b)(2). Finally, I presume that the ESOP is a qualified trust as defined in 26 U.S.C. §401(a). Section 401(a)(11)(C) incorporates by reference to 26 U.S.C. §409(a) a tax credit employee stock ownership plan as a §401(a) trust.

As Alabama S corporations, neither Company A nor members of the A Group will be subject to Alabama's corporate income tax. Code of Ala. 1975, §40-18-160(a) specifically provides that an "Alabama S corporation shall not be subject to the tax imposed by [Code] Section 40-18-31."

As a general rule, the income of any trust as defined in §401(a) is exempt from Alabama income tax pursuant to Code of Ala. 1975, §40-18-25(e). By application of that rule, it would appear that the income of the ESOP would also be exempt from Alabama income tax. However, there is an exception to the rule for "any income which would constitute 'unrelated business taxable income' ['u.b.t.i.'] as defined in 26 U.S.C. §512, relating to unrelated business taxable income." Code of Ala. 1975, §40-18-25(e).¹ Therefore, the Alabama income tax treatment of the income distributions from Company A to the ESOP depends on whether such distributions constitute u.b.t.i. pursuant to §512.

Section 512's definition of u.b.t.i. was amended by the Taxpayer Relief Act of 1997. Specifically, in those cases where an employee stock ownership plan is an S corporation shareholder, income distributions from the S corporation were excluded from the §512 definition of u.b.t.i. See §512(e)(3), as amended. Accordingly, the income from Company A is not u.b.t.i. as defined by §512 because Company A is an S corporation.

Pursuant to Code of Ala. 1975, §40-18-1.1(b), all Internal Revenue Code ("IRC") references in Chapter 18, Title 40, Code, mean the IRC, "as in effect from time to time." As a result, the new definition of u.b.t.i. contained in §512 is incorporated into §40-18-25(e). The exception to the rule is not applicable in this case, because the income distributions from Company A to the ESOP are not u.b.t.i., as defined by §512. The income of the ESOP is exempt from Alabama income tax pursuant to §40-18-25(e).

¹There is another exception applicable to any entity which is not exempt from federal income tax by reason of 26 U.S.C. §502 or §503. However, that exception is apparently not relevant in this case.

RULING

Income distributions from Company A to the ESOP will not be subject to Alabama income tax.

H. E. "Gene" Monroe, Jr.
Commissioner of Revenue

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